

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

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CC:PSI:B02

PLR-146178-10

Date:

April 06, 2011

Legend

X =

Y =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Month =

Dear :

This responds to a letter dated November 2, 2010, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State Date1. On Date2, X executed and filed a Form 2553, Election by a Small Business Corporation, to be effective for the tax year beginning Date3. At the time this election was made, one of X's shareholders was Y, a corporation.

In Month, X discovered that Y was an ineligible shareholder and that its S election filed on Date2 was ineffective. Shortly thereafter, Y's stock was transferred and assigned to the individual owners of Y, effective Date4.

X represents that X and X's shareholders have filed tax returns consistent with X being an S corporation from Date3. X further represents that the circumstances resulting in the ineffectiveness of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and persons who were or are shareholders of X at any time since Date3 agree to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

Section 1361(a) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that meets the requirements specified in § 1361(b)(1)(A) through (D).

Section 1361(b)(1)(B) provides that S corporations may not have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual. Section 1.1361-1(f) provides that, except as otherwise provided in § 1.1361-1(e)(1) (relating to nominees), § 1.1361-1(h) (relating to certain trusts), and, for taxable years beginning after December 31, 1997, §1361(c)(6) (relating to certain exempt organizations), a corporation in which any shareholder is a corporation, partnership, or trust does not qualify as a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by a corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election made on Date2 was invalid because X had an ineligible shareholder at the time of the effective date of the election. We further conclude that the ineffectiveness of that election was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as being an S corporation beginning on Date3, and continuing thereafter, provided that X's S corporation election was otherwise valid and the election is not terminated under § 1362(d) for reasons not addressed in this letter.

Except as specifically set forth above, we express or imply no opinion concerning the federal income tax consequences of the facts described above under any other provision of the Internal Revenue Code and the regulations thereunder. Specifically, we express no opinion regarding whether X otherwise qualifies as a small business corporation under § 1361.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Melissa C. Liquerman  
Branch Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes

cc: